octaura

January 12, 2024

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Ann E. Misback, Secretary
Docket No. R-1813
RIN 7100-AG64

Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219
Attention: Chief Counsel's Office, Comment Processing
Docket ID OCC-2023-0008
RIN 1557-AE78

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments /Legal OES, James P. Sheesley, Asst. Executive Secretary
RIN 3064-AF29

RE: Capital Rule Proposal – Basel III Endgame (the "Proposed Rule")

Ladies and Gentlemen:

Octaura Holdings ("Octaura") is an innovative provider of electronic trading, data, and analytics solutions for syndicated commercial loans. Founded in 2022, Octaura represents a significant milestone in the advancement of trade modernization for these markets through common operational criteria, automation across pre- and post-trade life cycles, improved ease in transactions and advanced data and analytics.

In April 2023, Octaura launched the first comprehensive syndicated loan trading venue delivering trading protocols, real-time data and analytics, on a single platform.

We are writing to express our concern about the Proposed Rule, particularly as it would affect the securitization market for syndicated commercial loans and collateralized loan obligations ("CLOs"). From our perspective as a market participant, we have observed the effects of rapidly increasing borrowing costs on businesses. We believe that the Proposed Rule's unfavorable treatment of securitization will lead to even higher borrowing costs for businesses.

A large portion of syndicated commercial loans are financed via securitization. Banks are key players in the securitization market, not only because they securitize their own loans, but because they invest in and act as market-makers for CLOs. Regulatory changes that make it much more costly for banks to participate in that

market will make CLOs a much more costly form of financing for syndicated commercial loans. As a result, commercial loans will become more expensive and less available.

We have reviewed the comment letter on the Proposed Rule submitted by the Structured Finance Association ("SFA") and agree with its findings and recommendations. In this letter, we would like to emphasize five points that are particularly relevant.

First, many syndicated commercial loans are financed under warehouse financing facilities. Each of these warehouse facilities is a securitization exposure, which results from the transfer of the loans to a securitization special purpose entity that borrows the funds from a bank to purchase those loans. The bank's warehouse loan is a securitization exposure against which the bank must hold regulatory capital. Because of its higher p-factor, the proposed SEC-SA calculation method would require banks to hold significantly more capital against their warehouse securitization exposures than they do now. If the Proposed Rule is implemented, warehouse financing interest rates are likely to increase substantially, resulting in higher borrowing costs for businesses.

Second, banks act as market makers and investors in CLOs. The Proposed Rule, including SEC-SA, would apply regardless of whether a bank holds CLOs in its trading book or in its banking book. The Proposed Rule's significantly higher capital charge for these positions will compel banks to demand a higher return on the CLOs that they hold and/or reduce their participation in securitizations. Higher interest rates, decreased liquidity, and a smaller investor base for CLOs will all result in more expensive and less available credit for businesses.

Third, we wish to emphasize that CLOs are much different than the collateralized debt obligations ("CDOs") that FDIC Chairman Gruenberg referred to in his statement in support of the Proposed Rule.[1] While CDOs held a variety of debt instruments, including subprime RMBS and even other CDOs, CLOs invest in loans made to corporate borrowers. These loans are often secured by a lien on the corporation's assets and typically rank senior to the bonds issued by the corporation. CDOs and many of the other financial products that caused the losses referred to by Chairman Gruenberg no longer exist in the market. In contrast to CDOs, CLOs performed well during the global financial crisis, and exhibited strong performance again during COVID-19 pandemic.

Fourth, regulatory capital requirements for securitization exposures should not be based on outdated or incorrect perceptions of the market reality. CLOs that were issued before the global financial crisis (the "GFC"), known as the "CLO 1.0" generation of transactions, performed very well. According to S&P Global Ratings, of the 4,322 CLO classes rated by that firm, only 40 classes defaulted (of which, only 15 were investment-graded rated ('BBB-' or higher)).[2] Even so, the CLO market has undergone considerable evolution since the GFC. Among other things

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[1] See Statement by Martin J. Gruenberg, Chairman, FDIC, On Basel III Notice of Proposed Rulemaking (July 27, 2023) ("With respect to market risk, during the global financial crisis banks incurred significant losses in their trading books— that is their portfolios of instruments traded over the short-term—exposing weaknesses of the existing market risk capital framework. For example, credit markets, in particular those related to structured products like Collateralized Debt Obligations (CDOs), collapsed during the financial crisis. This severely impacted liquidity in these markets. Banks were able to use internal Value at Risk models for these positions even though the models inadequately captured the risks.")

[2] *See* S&P Global Ratings, Twenty-Five Years Strong: Update on CLO 1.0 Defaults, Aug. 12, 2019, available at: https://www.spglobal.com/ratings/en/research/articles/190812-twenty-five-years-strong-update-on-clo-1-0-defaults-11105026.

- Rating agencies require substantially more overcollateralization for CLOs issued after the GFC (known as the "CLO 2.0" generation) as compared to CLO 1.0.
- CLO 2.0 transactions are collateralized almost entirely by senior secured bank loans, rather than subordinated corporate bonds or structured finance products.
- The reinvestment period for CLO 2.0 transactions is considerably shorter than for CLO 1.0 transactions, thus reducing the risks associated with reinvestments, including adverse changes in prevailing market conditions.
- CLO 2.0 transactions benefit from much greater transparency and liquidity, in large part due to the electronic trading, data, and analytic solutions for syndicated commercial loans provided by Octaura and have performed even better than the CLO 1.0 generation.

Fifth, banks earn fee and commission income when they act as underwriters of CLOs. The proposed operational risk capital requirement would impose a new capital requirement on such fee and commission income, which could lead banks to charge higher fees and commissions, thus increasing the cost of issuing CLOs and, ultimately, the cost of credit to businesses. As the SFA's comment letter points out, the resulting costs are not outweighed by any benefit. The Federal Reserve's own study shows that securitization-based fee and commission income does not bear a statistically significant relationship to a bank's operational risks. Moreover, the operational risks relating to CLOs are significantly mitigated by technology, such as the electronic execution, advanced data and analytics, and the improved market accessibility for market participants provided by Octaura.

We are aware of no public policy objective that justifies the Proposed Rule's costs and burdens. Rather, as the SFA letter points out, statements from the Banking Regulators consistently point to the success of current regulatory capital rules, stress tests, and enhanced supervisory programs in ensuring that U.S. banks are well-capitalized.

As a service provider in the securitization market, we see no economic evidence suggesting that securitization has become more risky or volatile since the current regulatory capital rules were implemented. Many securitization-related regulatory changes have gone into effect in recent years, including extensive rating agency reform.

Unfortunately, the NPR lacks any data or sufficient explanation supporting the proposed significant increases in risk weights for securitization exposures. As a result, we are unable to fully understand and comment on the rationale for the Proposed Rule. However, the negative implications of the Proposed Rule are clear to us, and we hope that this letter will prompt the Banking Regulators to reconsider their approach.

We urge the Banking Regulators to either withdraw the Proposed Rule or implement the changes recommended by the SFA in its comment letter.

Thank you for the opportunity to provide these comments on the Proposed Rule. Please feel free to contact me at Jason.Cohen@Octaura.com if you have any questions or if you would like to discuss our comments further.

Jason Cohen
Chief Operating Officer & Chief Financial Officer
Octaura Holdings

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